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SUBJECT: FOOD PRICES - BLEAK OUTLOOK FOR AUSTRIAN CONSUMER

REF: (A) VIENNA 0965; (B) VIENNA 0945; (C) VIENNA 0621

Summary

1. Food prices are a continued concern in Austria and will remain high on the agenda of Austria's new government, to be elected in September 2008. The May 2008 inflation rate of 3.7% was the highest monthly rate in fifteen years, food price inflation was 7.2%. Food prices (excluding VAT) in Austrian supermarket chains are up to 20% higher than in Germany, even though suppliers reportedly under extreme press of these chains to hold cost down. A recent European Commission merger decision will result in even higher market concentration and could lead to a further rise in food prices. End Summary.

Continued High Food Price Inflation

2. The May 2008 CPI was up 3.7% from May 2007, the highest monthly rate in fifteen years. As in previous months, the CPI increase was mainly driven by the costs for energy and food. Prices for household energy were up 6.8%, food prices 7.2%. Consumers had to pay 41% more than a year ago for pasta, 11% more for bread and grain products, 16% more for dairy products, and 15% more for edible fats and oils 15%. Economic researchers now project an annual average CPI increase of 3.2-3.5%, with food prices expected to go up 7% and energy prices 13% (ref B). Austrian National Bank Governor Klaus Liebscher recently warned against populist proposals to lower the VAT, the petroleum tax or road tolls to relieve industry and consumers of inflation effects. Such steps would "open a Pandora's box," according to Liebscher, who suggested enforcing competition policies as an alternative.

High Retail Concentration - High Food Prices

3. As mentioned in ref C, domestic factors behind at least some of the food price rise are high retail concentration in the food sector, a lack of competition, and a weak competition authority. In the past twenty years, Austria's food trade underwent an unparalleled concentration from 11,600 shops in 1985 to 6,076 in 2007, combined with a doubling of the combined market share of supermarket chains REWE and Spar. Today, the top three chains hold a market share of 77.4% (REWE 30%, Spar 27.7% and Hofer 19.7%), according to the ACNielsen market research institute. Austria has one supermarket for 12,300 citizens, the second highest concentration in the EU after the UK.

4. Even though suppliers are reportedly under extreme pressure to hold cost down, prices in Austrian supermarkets average 13-20% higher than in Germany - excluding VAT, according to the Austrian Labor Chamber's consumer protection department. A food basket of 13 products costing Euro 17.56 in Passau, Germany costs Euro 21.33 in Vienna. Price increases for selected products in Viennese supermarkets over the last twelve months have also been exorbitant, e.g., for penne 80%, sunflower oil 65%, flour 23%, gouda cheese 20%, orange juice 16%, fruit yoghurt 14%, beer 12%.

¶5. In this situation, the European Commission's recent approval of the proposed takeover of ADEG, an Austrian chain with a 5.5% market share, by REWE pursuant to the EU Merger Regulation does not seem helpful. The Commission redefined the "critical market concentration" from the so far accepted regional 30% to 50%. Its argument that "the transaction would not significantly impede effective competition in the European Economic Area (EEA) or any substantial part of it" seems odd, particularly since the Commission could not exclude that REWE/ADEG deal would result in increased price levels on the Austrian retail market.

¶6. As a result of the Commission's decision, REWE's Austria-wide retail market share will go up to about 35%, in some Austrian regions to as much as 50%, despite a commitment to divest ADEG outlets. The combined market share of the top three chains in Austria (REWE/Billa, Spar, and Hofer) will rise from 77.4% to about 83%. In comparison, the market share of the top three chains elsewhere in Europe exceeds 65% only in Scandinavia, Belgium and Switzerland. The outlook for Austrian consumers seems bleak. Inflation, high food prices and competition policies will remain on the agenda for Austria's new government, to be elected in September 2008 (ref A).

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